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INTERNATIONAL ECONOMIC COMPARISONS

Current U.S. economic conditions remain more favorable than many analysts have predicted. Exports are growing fast and the January trade deficit showed a substantial improvement over that of the previous months. The seasonally adjusted unemployment rate declined by 0.3 percent, and consumer and business spending are expanding. Buoyancy in business spending has added to existing productive capacity and has improved productivity, somewhat easing pressures on prices and costs. Fears that the brisk economic expansion and resultant labor shortages might fuel inflationary pressures have induced the Federal Reserve Board to raise short-term interest rates, causing a decline in new home purchases. The moderate rise in the Consumer Price Index (0.4 percent), however, shows that inflation is still under control, despite sporadic increases in some commodity prices and a one-percent rise in the Producer Price Index in February. Relatively low oil prices, improved business confidence and profit margins, moderate wage increases, buoyancy of capital spending, and the lagged effects of the dollar depreciation are still propelling the economic expansion.

Economic Growth

The annualized rate of real economic growth during the fourth quarter of 1988 was 2.7 percent in the United States, 3.3 percent in the United Kingdom, 3.4 percent in Canada, and 2.7 percent in West Germany. The latest available data indicate that the rate of real economic growth (annualized) during the third quarter of 1988 was 3.0 percent in France, 3.9 percent in Italy, and 5.6 percent in Japan.

Industrial Production

U.S. industrial production remained unchanged in February after rising 0.4 percent in January. Output increased in business equipment and home goods, but output of construction supplies, materials, and automobiles declined. Within the manufacturing sector, total production of all major industries remained unchanged after rising a revised 0.7 percent in January. U.S. industrial production in February 1989 was 5.0 percent higher than it was in February 1988.

Other major industrial countries reported the following annual growth rates of industrial production: Italy reported an increase of 6.0 percent (year ending November 1988), Canada and France reported increases of 2.7 and 4.3 percent, respectively (year ending December 1988); the United Kingdom reported an increase of 1.5 percent (year ending January 1989); West Germany reported an increase of 5.3 percent; and Japan reported an increase of 9.4 percent.

Average overall capacity utilization in U.S. factories, mines, and utilities in February 1989 was 84.3 percent, down by 0.2 percent from January. In manufacturing, capacity utilization in February stood at 84.6 percent compared with 84.4 percent in January 1989, and 82.4 percent in February 1988.

Prices

The seasonally adjusted U.S. Consumer Price Index increased 0.4 percent from January to February 1989. During the 1-year period ending in January 1989, consumer prices increased 4.3 percent in Canada, 7.5 percent in the United Kingdom, 3.3 percent in France, 4.7 percent in the United States, 1.1 percent in Japan, and 5.7 percent in Italy. During the 1-year period ending in February 1989, consumer prices increased 2.6 percent in West Germany.

Employment

The seasonally adjusted rate of unemployment in the United States (on a total labor force basis, including military personnel) declined to 5.1 percent in February from 5.4 percent in January 1989. West Germany reported an employment rate of 7.9 percent in February 1989. The national statistical offices of other countries reported the following unemployment rates in January: the United Kingdom, 7.0 percent; Japan, 2.3 percent: Italy, 16.4 percent; France 10.2 percent; and Canada, 7.6 percent. (For foreign unemployment rates adjusted to U.S. statistical concepts, see the tables at the end of this issue.)

The Budget Deficit

Table 1 shows Congressional Budget Office (CBO) projections of the budget deficit from 1988 to 1994. These projections are based on lower rates of economic growth and higher rates of interest and inflation than those used in projections by the Office of Management and Budget (OMB). Underlying the CBO's projections is the assumption that the economy has reached high levels of capacity utilization and that any further expansion would increase inflation and trigger monetary restraint to slow the economy to sustainable rates of growth.

Table 1

CBO baseline budget projections, [1] by fiscal year, 1988-94

(In billions of dollars)

Item	1988	1989	1990	1991	1992	1993	1994
Deficit	155	155	141	140	135	129	122
Deficit target[2]	144	136	100	64	28	0	-
Deficit as a percent of GNP	3.2	3.0	2.6	2.4	2.2	2.0	1.7
Economic assumptions:							
GNP[3]	4,859	5,209	5,542	5,902	6,281	6,685	7,117
Real GNP growth rate	3.8	2.9	2.1	2.2	2.2	2.3	2.3
Implicit GNP deflator	3.3	4.2	4.2	4.2	4.1	4.1	4.1

[1] The baseline budget projections include Social Security, which is off-budget.
[2] The Balanced Budget and Emergency Deficit Control and Reaffirmation Act of 1987 established these targets for 1988 through 1993.
[3] Calculated in billions of current dollars.

Source: Congressional Budget Office. The Economic and Budget Outlook: Fiscal Years 1990-1994. A Report to the Senate and House Committees on the Budget—Pt. 1.

U.S. Public Debt

Table 2 shows public debt as a percent of GDP/GNP for the Group of 7 (G-7), from 1980 to 1988, with projections to 1990. Over the 1980-88 period, U.S. public debt was lower than the average public debt of the G-7 as a group, and was also lower than the public debt of Japan, Italy, and Canada.

Forecasts

Table 3 shows newly revised macroeconomic projections for the U.S. economy in 1989, by four major forecasters, and the simple average of these forecasts. The forecasts represent percentage changes over the preceding quarterly period at annual rates. The average forecast is for a decline in nominal and real GNP growth rates starting the second quarter of 1989 and a slight increase in unemployment rates. The causes of the predicted economic downturn are a projected moderation in the pace of consumer spending, a decline in export growth, and a rise in short-term interest rates. Export growth rates are expected to slow, as the dollar appreciates in response to higher interest rates. Inflation (measured by the GNP deflator index) is expected to rise in the second and third quarters and moderate in the fourth quarter of 1989.

The OECD projects a 3.0 percent growth rate in U.S. real GNP for 1989, matching the average growth rate of OECD-Europe, and 2.5 percent growth in total demand, a half percentage point below the OECD-Europe average. The OECD projects that the U.S. inflation rate will reach 4.5 percent, a quarter percentage point lower than the OECD-Europe average inflation rate, and that U.S. unemployment rate will be at 5.5 percent compared with a 10.25-percent OECD-Europe average rate. The U.S. deficit on current account will reach $116 billion in 1989. World trade is projected to grow by 7.5 percent in 1989, compared with a growth rate of 9.0 percent in 1988.

In its latest forecasts, the International Monetary Fund (IMF) predicts that the overall output of industrial countries will increase by 2.8 percent in 1989 compared with a 3.9-percent increase in 1988, and inflation will rise slightly to 3.5 percent compared with 3.0 percent in 1988. Output of developing countries is expected to increase by 4.0 percent in 1989 compared with 3.6 percent in 1988. World trade is projected to grow by 5.6 percent in 1989 compared with 7.6 percent in 1988.

Table 2

Public Debt as a percent of GNP/GDP of G-7, 1980-90

Item	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
United States	37.9	37.2	41.3	44.1	45.2	48.4	51.2	51.6	51.3	50.7	49.8
Japan	52.0	57.0	61.1	66.9	68.4	69.3	69.3	68.6	67.3	66.2	65.3
West Germany	32.5	36.3	39.5	40.9	41.5	42.2	42.4	43.3	44.1	44.3	45.0
France	37.3	36.4	40.1	41.4	43.9	45.5	46.0	47.3	47.3	47.7	48.2
United Kingdom	54.6	54.7	53.4	53.6	54.9	53.6	52.9	50.4	46.1	42.1	38.6
Italy	58.5	60.5	66.3	71.9	77.0	83.6	87.9	91.3	94.2	97.2	100.4
Canada	44.7	45.1	50.5	54.5	58.0	63.4	67.2	69.0	69.5	70.4	71.1
Total	42.4	43.3	47.1	50.1	51.7	54.2	55.9	56.3	55.9	55.4	55.0

Source: OECD Economic Outlook, December 1988.

Table 3

Projected quarterly percentage changes of selected U.S. economic indicators, and unemployment rate, 1989

Indicator and quarter	*Data Resources Inc.*	*Merill Lynch Economics Inc.*	*Wharton F.A. Inc.*	*UCLA Business Forecasting Project*	*Mean of 4 forecasts*
GNP:[1]					
January-March	8.1	9.5	9.1	8.8	8.9
April-June	5.2	6.7	6.6	5.1	5.9
July-September	4.9	4.2	6.2	4.2	4.9
October-December	5.0	3.7	6.8	4.7	5.0
GNP:[2]					
January-March	5.1	5.1	4.9	5.7	5.2
April-June	1.5	2.2	2.1	.0.9	1.7
July-September	0.9	-0.3	1.7	-0.3	2.0
October-December	1.4	-0.6	1.7	0.4	0.7
GNP deflator index:					
January-March	2.8	4.2	4.7	2.9	3.6
April-June	3.7	4.4	4.6	4.2	4.2
July-September	4.0	4.5	4.4	4.5	4.3
October-December	3.5	4.3	3.8	4.3	4.0
Unemployment rate:[3]					
January-March	5.4	5.3	5.3	5.2	5.3
April-June	5.5	5.3	5.4	5.2	5.3
July-September	5.5	5.4	5.5	5.2	5.4
October-December	5.6	5.8	5.6	5.4	5.6

[1] Current dollars.
[2] Constant dollars.
[3] Annual rate.

Note.—Percentage changes in the forecast represent compounded annual rates of change from preceding period. Quarterly data are seasonally adjusted.

Source: Compiled from data presented in The Conference Board, *Statistical Bulletin*, vol.21, No.11, November 1988. Used with permission.

U.S. Balance of Payments

Table 4 shows the U.S. balance of payments in 1983–88. The merchandise trade balance is the difference between merchandise imports and exports. The current account is the merchandise trade balance plus the balance on trade in services, which is composed largely of income on foreign investment. As a result of the large merchandise trade deficits and the rise in investment income payments to foreigners, the U.S. current account shows growing yearly deficits from 1983 to 1988. Concomitant with these deficits, foreign capital inflows increased markedly during this period, totaling $697 billion. U.S. net assets (direct and indirect investment) abroad grew by $348.0 billion during this period and net foreign assets in the United States grew by $936.2 billion. U.S. receipts from investment abroad totaled $548.3 billion and payments to foreigners totaled $437.0 billion.

U.S. TRADE DEVELOPMENTS

The seasonally adjusted U.S. merchandise trade deficit declined by 13.6 percent, from $11.0 billion in December 1988 to $9.5 billion in January 1989. The January deficit was 5.0 percent lower than the $10.0 billion average monthly deficit registered during the previous 12-month period, but was only 3.1 percent lower than the $9.8 billion deficit registered in January 1987. During the period from January 1988 to January 1989, the deficit was highest in February 1988 ($13.2 billion) and lowest in July 1988 ($8.8 billion).

Seasonally adjusted exports declined by $1.3 billion, from $29.1 billion in December 1988 to $27.8 billion in January 1989. Imports, however, declined more than exports, from $40.0 billion in December 1988 to $37.3 billion in January 1989.

In manufactured goods, total exports and imports decreased; however, imports declined more than exports. Consequently, the manufactures trade deficit declined by $1.8 billion, from $10.2 billion in December 1988 to $8.6 billion in January 1989. By commodity group, the biggest percentage gains in exports of manufactures were registered in chemical fertilizers, railway vehicles, nickel, power generating machinery, new cars, and undocumented exports to Canada. The biggest percentage decreases in imports were in automatic data processing equipment, office machinery, airplanes, airplane parts, pharmaceuticals, electrical machinery, glass, nonmonetary

Table 4
U.S. balance of payments, 1984-88.

(In billions of dollars)

Item	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*
Merchandise trade:						
Exports	201.8	219.9	215.9	224.0	249.6	316.3
Imports	-268.9	-332.4	-338.1	-368.5	-409.8	-441.5
Balance on merchandise trade [3]	-67.1	-112.5	-122.2	-144.5	-160.3	-125.2
Investment income:						
Receipts	77.3	85.9	88.8	90.1	103.8	102.4
Payments	-52.4	-67.4	-62.9	-67.0	-83.4	-103.9
Net	24.9	18.5	25.9	23.1	20.4	-1.5
Net military transactions	-.2	-2.1	-3.4	- 4.4	-2.4	-3.9
Net travel and transportation receipts	-4.2	-8.6	-10.0	-9.3	-10.3	-7.2
Other services, net	9.9	9.8	9.6	11.6	12.0	14.0
Balance on goods and services	-36.8	-95.0	-100.1	-123.5	-140.5	-123.8
Unilateral transfers	-9.5	-12.1	-15.0	-15.3	-13.4	-12.0
Balance on current account	-46.2	-107.1	-115.1	-138.8	-154.0	-135.8
Capital account:						
U.S. assets abroad, net	-49.8	-22.3	-32.6	-98.0	-76.0	-69.3
U.S. Official reserve assets[2]	-1.2	-3.1	-3.9	0.3	9.1	-7.8
Other U.S. Governments assets	-5.0	-5.5	-2.8	-2.0	1.2	0.4
U.S. private assets	-43.6	-13.7	-26.0	-96.3	-86.3	-62.0
Foreign assets in the United States, net	84.9	102.6	129.9	221.2	211.5	186.1
Foreign Official assets	5.8	3.1	-1.2	35.5	45.0	36.9
Other foreign assets	79.0	99.5	131.1	185.7	166.5	149.2
Statistical discrepancy	11.1	26.8	17.8	15.6	18.5	19.2
Balance on capital account	46.2	107.1	115.1	138.8	154.0	135.8

[1] First three quarters of 1988 are annualized.
[2] Consists of gold, special drawing rights, foreign currencies, and the U.S. reserve position in the International Monetary Fund (IMF).
[3] Because of rounding, figures might not add to totals.

Note.—Capital outflows (-), Capital inflows (+).

Source: *Economic report of the President*, Jan. 1989.

gold, metalworking machinery, musical instruments, photographic supplies, power generating machinery, scientific instruments and parts, specialized industrial machinery, telecommunications apparatus equipment and parts, textile yarns and fabrics, and new cars from Japan. The oil import bill increased from $3.3 billion to $3.6 billion. The agricultural trade surplus declined from $1.9 billion in December 1988 to $1.4 billion in January 1989.

On a regional basis, the United States experienced improvements in its deficits with Western Europe, Japan, and the Newly Industrialized Economies (NIEs), and a worsening in its trade deficit with Canada and communist areas in Europe and Asia. The trade balance with Western Europe turned from a deficit of $1.2 billion in December 1988 into a surplus of $46 million. The deficit with Japan declined from $5.1 billion in December 1988 to $3.5 billion in January 1989. The deficit with West Germany declined from $1.3 billion to $716 million. The deficit with the NIEs declined slightly to $2.4 billion from $2.5 billion. The deficit with Canada worsened by almost one-half, from $985 million in December to $1.7 billion in January, and the deficit with developing countries as a whole increased from $3.2 billion to $4.3 billion. The deficit with OPEC nations increased from $620 million in December 1988 to $1.1 billion in January 1989.

INTERNATIONAL TRADE DEVELOPMENTS

Expansion of CBI Program Appears Likely

The Caribbean Economic Recovery Act (CBERA), commonly referred to as the Caribbean Basin Initiative (CBI), went into effect on January 1, 1984, with the objective of stimulating growth and promoting structural reform of the economies of the Caribbean Basin. Currently 22 Caribbean countries are designated as beneficiaries of the program. One objective of the CBI program was to enhance the Caribbean Basin's export earnings and encourage export diversification by granting beneficiary countries duty-free trade access to the U.S. market on selected products. Debate has persisted, however, over the program's scope and impact on the beneficiary economies. One central issue has been the legislatively mandated restrictions that exclude certain products from the program.

Some critics have pointed to the nearly 31-percent decline in U.S. imports from the Caribbean Basin since the inception of the CBI as an indication of the program's failure (see table 5). However, exports from the region to the United States have actually increased in value, apart from petroleum imports for which the world price has declined substantially. More importantly, over the last four years the value of imports entering duty free under the CBI program have increased nearly 40 percent, outpacing the 35-growth in total U.S. imports. After climbing steadily since 1985, however, CBI imports dropped slightly in 1988 to about $801 million. Last year, imports entering under the CBI accounted for 13 percent of all U.S. imports from the Caribbean, the same share as those in 1987, and less than 2 percent of total U.S. imports.

To address concerns that the current CBI has not achieved the results intended, on March 2 Chairman Sam Gibbons of the House Ways and Means Trade Subcommittee and Senator Bob Graham introduced the Caribbean Basin Economic Recovery Expansion Act (H.R.1233 and S.504), commonly referred to as CBI-II. Such legislation was previously introduced in August 1987 (H.R.3101 and S.1544), but did not come to a vote. The CBI-II bills now being considered would repeal the September 30, 1995 expiration date of CBI, extending the program indefinitely, and would grant limited duty-free preferences to items that are currently exempt from the program.

Products that are ineligible for duty-free treatment under the existing CBI include: certain items of footwear, handbags, luggage, flatgoods, work gloves, and leather wearing apparel that are not eligible for duty-free entry under the Generalized System of Preferences; canned tuna; petroleum and petroleum products; and watches and watch parts of which any component originated in a Communist country. As proposed, the legislation would group these products into "special categories," each of which would receive duty-free treatment up to a level equaling 5 percent of the total quantity of U.S. imports in that category. If in any year CBI imports should exceed the 5-percent limit, the following year each beneficiary would be subject to a "national duty-free quota" for that category. For each country and product category, the "national duty-free quota" would be calculated as the quantity of imports the prior year plus 3 percent. In 1988, the United States imported almost $1.1 billion worth of these articles from CBI beneficiaries (see table 6). Duties collected on these imports were estimated at almost $14 million. Inclusion of these products would have more than doubled the value of CBI imports last year.

The CBI-II bills also propose expanding duty-free treatment for textile and apparel imports. As written in the legislation, duty-free access would be granted on the total value of textile and apparel imports that are made from "qualifying fabrics" and those that enter under Guaranteed Access Level (GAL) quotas which are negotiated with each beneficiary. "Qualifying" fabrics are those formed and cut in the United States and certain foreign fabrics that are of a type not produced in the United States or that are in "critical supply." Most textile and apparel imports are excluded from the existing CBI program. However, countries designated under the CBI are the sole beneficiaries of the 807-A program, which allows duty-free treatment for textile and apparel imports entering under GALs, but only on the "qualifying fabric" component. (Under the new Harmonized System tariff nomenclature that took effect January 1, 1989, item TSUS 807-A HTS 9802.00.80.10.) Textile and apparel imports entering under item 807-A grew from about $1.0 million in 1986, the first year of the program, to $219.3 million last year. The dutiable value of 807-A imports totaled $57.6 million in 1988.

Table 5

U.S. imports for consumption from countries in the Caribbean Basin, 1984-88[1]

(In thousands of dollars, customs value)

Imports	1984	1985	1986	1987	1988
Total	8,896,499	6,849,928	6,186,826	6,178,052	6,172,278
CBI duty-free	576,906	497,309	680,463	802,567	800,791
CBI as percent of total	6.5	7.3	11.0	13.0	13.0

[1] Figures are for designated and nondesignated countries under the CBERA and are net of certain MFN duty-free items that were erroneously included in the trade statistics.

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table 6

U.S. imports from CBI beneficiaries of selected items currently exempt from program benefits, customs value, and calculated duties collected, 1988 [1]

(In thousands of dollars)

Item	Calculated Customs value	Duties Collected
Total	1,099,937	13,918
Petroleum and petroleum products	1,053,476	8,227
Handbags,luggage, and flatgoods	20,244	2,760
Footwear	15,357	1,685
Work Gloves	7,429	1,039
Leather apparel	3,386	203
Watches and parts ..	31	3
Canned Tuna	14	1

[1] Figures are preliminary and are for countries designated as beneficiaries as of Jan. 1, 1989.

Source: Compiled from official statistics of the U.S. Department of Commerce.

Another provision of the new CBI-II legislation allocates a minimum sugar quota to program beneficiaries. The bills set a floor for overall CBI sugar imports at the actual 1989 aggregated CBI quota of 371,449 metric tons. The 1989 global sugar quota is 1,123,440 metric tons. If the global sugar quota shrinks again, as was the trend until the 1988 drought induced an increase, the shares of other supplying countries will inevitably be squeezed.

The CBI-II bills also provide for a separate injury determination for CBI beneficiaries in countervailing duty and antidumping cases; an increase in the duty-free allowance for U.S. residents returning from a CBI beneficiary country (from $400 to $600); and the establishment of a pilot customs program to test the effect of preclearance operations on tourism in the region.

Chairman Sam Gibbons is optimistic that legislation modifying the CBI program will pass this year. In introducing H.R. 1233, he noted that several of the more controversial provisions of the earlier CBI-II legislation had been removed or modified to address concerns raised during the course of consultations and hearings. With bipartisan backing and Bush administration support for strengthening the CBI program, legislative action appears likely during this session of Congress. Bill S.504 has been referred to the Senate Finance Committee and bill H.R.1233, which is currently in subcommittee, is expected to reach the full committee for consideration by mid-April.

Japan-United States FSX Project Approved With Modifications

A joint United States-Japan plan to develop a next-generation fighter support plane, the FSX (an adaptation of the F-16), was approved by President Bush pending certain modifications to the original agreement. The original agreement was reached between the U.S. Department of Defense and the Japan Defense Agency but ran into opposition from the Congress and trade Agencies. Now, the Japanese Government must approve the modifications before the agreement goes forward to Congress. Negotiations with Japanese officials have left several major issues unresolved, but reportedly the agreement is expected to go forward.

The joint plan has been the subject of criticism and opposition from Congress, some Government agencies, and private parties, and has been the subject of a White House-mandated interagency review. According to press reports, the agreement divided President Bush's Cabinet: the National Security Council and the State and Defense Departments supported the agreement, but the Commerce Department and other economic and trade agencies opposed it. At a Cabinet meeting on March 16, the various agencies presented three possible options to the President: go forward with the project as negotiated; modify the terms of the agreement by imposing stricter safeguards on technology transfer to Japan; or scrap the agreement entirely and induce the Japanese to buy F-16's. The President confirmed on March 21 that he had decided to approve the agreement, but with certain clarifications to better protect the computer "source code" that helps fly and control the plane and processes other sensitive data. The administration will also require that some of the jets be built in the United States.

The FSX will be based upon General Dynamic's F-16 technology and will replace Japan's aging F-1s and F-4s. The plans are to build approximately 130 planes at an estimated cost of $42.2 million each, with followup orders expected. Mass production of the planes is scheduled for 1997. The total cost of the project is estimated at $8.2 billion. Japan will pay for the cost of development, which is expected to cost an estimated $1.3 billion (at Y125=$1.00). U.S. firms' share of the research and development work will be between 35 and 45 percent. The Defense Department and the U.S. companies will also share the costs of design and prototype testing.

Several issues remain unresolved: what proportion of the FSX should be produced by U.S. firms (the administration is reportedly pressing for 40 percent), how much of the technology

arising from the design will flow back to the United States, and who will have the patent rights to that technology. Following approval of the changes by the Japanese Government, the Administration will submit the agreement to Congress. Unless Congress passes a joint resolution specifically prohibiting the agreement, an export license permitting the export of the technology will be issued and the plan will go into effect.

Negotiations between the United States and Japan began during the fall of 1987 then progressed slowly. A memorandum of understanding (MOU) on development of the fighter was negotiated with the Japanese by the State and Defense Departments, and signed on November 29, 1988. At first the two Governments disagreed over how the research, development, and production phases would be split between companies in Japan and the United States. Another area of disagreement was the transfer of technology back to the United States. Of particular concern were Japanese technical refinements to existing F-16 technology and the availability of new technology developed by the Japanese. The agreement now says that Japanese refinements to U.S.-developed technology already incorporated in the F-16 will be shared with the United States at no cost. New technology developed by the Japanese would have to be purchased by U.S. firms.

When the agreement was finally signed by Defense Department and Japan Defense Agency officials, it left a number of details to be worked out by the firms involved. Mitsubishi Heavy Industries, the primary Japanese contractor, and General Dynamics, the primary American contractor, disagreed on several issues in the months following the signing. In particular, the question of which firms would develop and produce the wing technology was difficult to resolve. Both companies wanted the wing prototypes to be developed and built in their own country. The two companies finally agreed that Japan will take the primary role in remodeling and developing the main wing. Main wings for two of the six FSX planes produced on an experimental basis, however, will be manufactured by General Dynamics in the United States using the same designs and raw material as Mitsubishi Heavy Industries. The wings will then be shipped to Japan for assembly and testing.

In early February the bilateral agreement ran into another snag when members of Congress wrote to the President and expressed their concern that the long-term impact on the health and competitiveness of the American aerospace industry had not adequately been taken into consideration during the negotiations. They urged that a review of the agreement be conducted by all pertinent Cabinet departments. Once the review began, interagency differences over the sharing of technology and concerns that the agreement amounted to a giveaway of U.S. technology delayed consensus on the agreement. During February and March, Congressional opposition continued to mount, several hearings were held, additional letters of concern were sent to the President, and the General Accounting Office was asked to study the competitive effect of the agreement upon the U.S. aircraft industry.

The current controversy over joint development of the FSX is ironic. Originally, the Japanese intended to develop and build a fighter by themselves, with no participation by the United States. It was only after suggestions by U.S. officials that Japan purchase F-16s "off the shelf" (to reduce Japan's trade imbalance) were rejected, that the Japanese were convinced that a joint project would be mutually beneficial for both trade and defense reasons. The U.S. defense industry believed that it would benefit from the agreement because of the development of new technology that could be used to improve the F-16 or other defense equipment. The State Department believed that the joint project would prove beneficial for both foreign policy and defense reasons, and at the same time, contribute to reducing the trade deficit the United States has with Japan.

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STATISTICAL TABLES

Industrial production, by selected countries and by specified periods, January 1986–January 1989

(Percentage change from previous period, seasonally adjusted at annual rate)

				1987	1988				1988					1989
Country	1986	1987	1988	IV	I	II	III	IV	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.
United States	1.1	3.8	5.7	7.1	4.0	4.5	7.1	4.7	4.4	.9	6.2	4.4	6.2	4.4
Canada	.8	2.7	4.2	4.4	4.1	3.7	4.4	2.3	1.9	1.9	0	6.7	.0	4.7
Japan	-.3	3.4	9.4	15.7	13.5	-1.0	10.2	9.2	37.6	6.5	-11.8	39.5	6.3	21.2
West Germany ...	2.2	.2	2.9	2.9	9.9	-.8	6.0	.9	40.5	4.6	-22.8	9.5	19.6	(1)
United Kingdom ..	2.3	3.4	3.8	3.8	-1.3	6.7	6.0	-1.0	4.4	4.4	-6.3	7.8	-19.5	(1)
France	.9	2.2	4.3	3.9	2.6	3.8	11.7	-3.6	0	11.6	-35.6	55.3	-10.3	(1)
Italy	3.8	2.6	5.5	14.0	10.0	-2.1	15.6	5.4	31.3	-17.8	1.1	11.5	40.8	(1)

[1] Not available.

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, Mar. 10, 1989.

Consumer prices, by selected countries and by specified periods, January 1986–February 1989

(Percentage change from previous period, seasonally adjusted at annual rate)

				1987	1988				1988						1989
Country	1986	1987	1988	IV	I	II	III	IV	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.
United States	1.9	3.7	4.1	3.6	3.4	4.8	4.7	4.4	5.2	4.1	5.1	3.0	4.1	7.2	(1)
Canada	4.2	4.4	4.0	3.5	3.4	4.7	4.4	3.9	5.1	4.6	4.7	2.2	2.1	6.8	(1)
Japan	.6	.1	.7	1.1	-2.1	2.8	.7	3.1	3.6	9.9	6.0	-4.6	-3.5	-2.3	-8.0
West Germany ...	-.2	.3	1.2	0	.7	1.9	1.9	1.8	3.2	1.6	.6	2.9	1.3	9.0	5.1
United Kingdom ..	3.4	4.1	4.9	4.9	2.7	6.5	8.6	8.3	13.4	7.1	11.7	4.0	6.1	8.6	(1)
France	2.5	3.3	2.7	2.4	2.3	2.9	3.8	3.0	4.3	3.4	2.7	2.3	3.6	3.7	(1)
Italy	6.1	4.6	5.0	5.7	3.4	4.8	5.9	6.6	7.7	5.1	6.4	8.1	5.9	6.4	7.5

[1] Not available.

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, Mar. 10, 1989.

Unemployment rates,[1] by selected countries and by specified periods, January 1986–February 1989

(In percent)

				1987	1988				1988				1989	
Country	1986	1987	1988	IV	I	II	III	IV	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.
United States	7.0	6.2	5.5	5.9	5.7	5.5	5.5	5.3	5.4	5.3	5.4	5.3	5.4	5.1
Canada	9.6	8.9	7.8	8.2	7.8	7.7	7.8	7.7	7.8	7.9	7.9	7.7	7.6	(2)
Japan	2.8	2.9	2.5	2.7	2.7	2.5	2.6	2.4	2.5	2.5	2.4	2.3	2	(2)
West Germany ...	7.0	6.9	7.1	7.0	7.1	7.2	7.1	7.0	6.9	6.9	7.0	6.8	6.6	(2)
United Kingdom ..	11.2	10.3	8.3	9.5	9.0	8.6	8.0	7.6	7.9	7.8	7.6	7.3	7.2	(2)
France	10.6	10.8	10.5	10.6	10.6	10.5	10.6	10.4	10.6	(2)	10.3	10.5	10.5	(2)
Italy	7.5	7.9	7.9	8.1	7.9	7.9	8.0	7.9	(2)	(2)	(2)	(2)	(2)	(2)

[1] Seasonally adjusted; rates of foreign countries adjusted to be comparable with U.S. rate.
[2] Not available.
Note.—Italian unemployment surveys are conducted only once a quarter, in the first month of the quarter.
Source: Statistics provided by Bureau of Labor Statistics, U.S. Department of Labor, March 1989.

Trade balances, by selected countries and by specified periods, January 1985-January 1989

(In billions of U.S. dollars, f.o.b. basis, at an annual rate)

				1987	1988				1988					1989
Country	1986	1987	1988	IV	I	II	III	IV	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.
United States[1]	-155.1	-152.1	-119.7	-154.2	-131.0	-114.8	-111.4	-121.7	-127.8	-110.3	-105.4	-127.9	-131.9	-113.9
Canada	7.1	8.3	7.2	4.4	7.2	8.4	10.4	3.2	7.2	4.8	4.8	3.6	3.6	([2])
Japan	92.5	96.2	94.6	91.6	99.6	86.4	90.4	102.0	87.6	90.0	102.0	102.0	102.0	99.6
West Germany[3]	52.6	65.6	72.8	74.0	64.4	78.4	71.6	76.4	79.2	66.0	67.2	84.0	78.0	([2])
United Kingdom	-12.6	-16.9	-36.0	-21.2	-28.4	-32.0	-38.8	-44.8	-37.2	-25.2	-56.4	-40.8	-38.4	-44.4
France	.1	-5.2	-5.8	-4.4	-2.8	-4.0	-8.0	-8.4	-16.8	1.2	-8.4	-7.2	-9.6	-4.8
Italy	-2.0	-8.7	-10.0	-10.8	-12.4	-4.4	-10.4	-14.0	-4.8	-19.2	-19.2	-10.8	-12.0	-24.0

[1] 1986, exports, f.a.s. value, adjusted; imports, c.i.f. value, adjusted. Beginning with 1987, figures were adjusted to reflect change in U.S. Department of Commerce reporting of imports at customs value, seasonally adjusted, rather than c.i.f. value.
[2] Not available.
[3] Imports, c.i.f value, adjusted.

Source: *Economic and Energy Indicators*, U.S. Central Intelligence Agency, Mar. 10, 1989, and *Advance Report on U. S. Merchandise Trade*, U.S. Department of Commerce, Mar. 15, 1989.

U.S. trade balance,[1] by major commodity categories, by selected countries, and by specified periods, January 1985-January 1989

(In billions of U.S. dollars, customs value basis for imports)

				1987	1988				1988					1988
Country	1986	1987	1988	IV	I	II	III	IV	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.
Commodity categories:														
Agriculture	4.5	7.0	13.9	3.2	3.0	3.3	3.1	4.5	0.8	1.4	1.4	1.4	1.7	1.4
Petroleum and selected products (unadjusted)	-31.8	-39.5	-38.1	-10.1	-9.7	-9.9	-9.5	-9.0	-3.4	-3.0	-2.9	-2.9	-3.2	-3.2
Manufactured goods	-134.3	-146.1	-146.7	-36.2	-35.0	-35.5	-36.8	-39.4	-12.6	-11.4	-13.6	-13.8	-12.0	-8.6
Selected countries:														
Western Europe	-28.2	-27.9	-17.2	-6.9	-4.0	-3.9	-4.6	-4.7	-1.4	-.9	-1.1	-2.0	-1.6	([3])
Canada[2]	-23.0	-11.5	-12.6	-3.1	-3.8	-4.1	-2.6	-2.1	-.4	-.9	-.9	-.8	-.4	-1.7
Japan	-55.3	-58.0	-55.5	-14.5	-13.1	-12.9	-13.3	-16.2	-4.8	-4.1	-5.5	-5.3	-5.4	-3.5
OPEC (unadjusted)	-8.9	-13.7	-10.7	-3.3	-2.6	-3.1	-2.8	-2.2	-1.2	-.7	-.8	-.6	-.8	-1.1
Unit value of U.S. imports of petroleum and selected products (unadjusted)[4]	$15.02	$18.12	$14.19	$18.40	$15.10	$15.00	$14.07	$12.68	$14.07	$13.52	$12.52	$12.42	$13.10	$14.46

[1] Exports, f.a.s. value, unadjusted. 1986-88 imports, c.i.f. value, unadjusted; 1989 imports, customs value, unadjusted.
[2] Beginning with February 1987, figures include previously undocumented exports to Canada.
[3] Less than $50,000,000.
[4] Beginning with 1988, figures were adjusted to reflect change in U.S. Department of Commerce reporting of imports at customs value, seasonally unadjusted, rather than c.i.f. value.

Source: *Advance Report on U.S. Merchandise Trade*, U.S. Department of Commerce, Mar. 15, 1989.

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Money-market interest rates,[1] by selected countries and by specified periods, January 1986–February 1989

(Percentage, annual rate)

Country	1986	1987	1988	1987 IV	1988 I	II	III	IV	1988 Sept.	Oct.	Nov.	Dec.	1989 Jan.	Feb.
United States	6.5	6.8	8.0	7.6	6.7	7.6	8.1	8.8	8.2	8.4	8.8	9.2	9.2	9.5
Canada	9.2	8.4	9.6	8.9	8.6	9.1	9.9	10.9	10.5	10.5	10.9	11.2	11.3	([2])
Japan	5.0	3.9	4.4	3.9	3.8	3.8	5.3	4.6	4.2	4.3	4.2	4.2	4.2	([2])
West Germany	4.6	4.0	4.3	4.1	3.4	3.6	5.0	5.1	4.9	5.0	4.9	5.3	5.6	([2])
United Kingdom	10.9	9.6	8.9	9.2	8.6	3.4	11.3	12.4	12.1	11.9	12.2	13.1	13.1	([2])
France	7.7	8.1	7.9	8.4	7.9	7.7	7.6	8.4	7.9	7.9	8.0	8.4	8.6	([2])
Italy	12.6	11.2	11.0	11.5	10.8	10.7	11.1	11.6	11.3	11.3	11.5	12.0	11.8	([2])

[1] 90-day certificate of deposit.
[2] Not available.
Note.—The figure for a quarter is the average rate for the last week of the quarter.

Source: *Federal Reserve Bulletin*, Board of Governors of the Federal Reserve System, March 1989, and *Federal Reserve Statistical Release*, Selected Interest Rates, Board of Governors of the Federal Reserve System, Mar. 13, 1989.

Effective exchange rates of the U.S. dollar, unadjusted and adjusted for inflation differential, by specified periods, January 1986–February 1989

(Percentage change from previous period)

Item	1986	1987	1988	1987 IV	1988 I	II	III	IV	1988 Sept.	Oct.	Nov.	Dec.	1989 Jan.	Feb.
Unadjusted:														
Index[1]	106.0	94.1	88.0	90.3	87.5	86.5	90.9	87.2	91.3	88.8	86.6	86.2	88.1	88.5
Percentage change	-16.5	-11.2	-6.5	-5.1	-3.1	-1.1	5.1	-4.1	0	-2.7	-2.5	-.5	2.2	.4
Adjusted:														
Index[1]	100.9	90.2	85.9	87.4	84.9	84.1	88.8	85.7	89.3	87.2	85.3	84.6	87.0	89.5
Percentage change	-17.1	-10.6	-3.1	.5	-2.9	-.9	5.6	-3.5	.1	-2.4	-2.2	-.8	2.8	2.9

[1] 1980-82 average=100.
Note.—The foreign-currency value of the U.S. dollar is a trade-weighted average in terms of the currencies of 15 other major nations. The inflation-adjusted measure shows the change in the dollar's value after adjusting for the inflation rates in the United States and in other nations; thus, a decline in this measure suggests an increase in U.S. price competitiveness.

Source: Morgan Guaranty Trust Co. of New York, March 1989.

INTERNATIONAL ECONOMIC COMPARISONS

U.S. TRADE DEVELOPMENTS

INTERNATIONAL TRADE DEVELOPMENTS:

Expansion of CBI program appears likely

Japan-United States FSX project approved with modifications

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INTERNATIONAL ECONOMIC COMPARISONS

Current U.S. economic conditions remain more favorable than many analysts have predicted. Exports are growing fast and the January trade deficit showed a substantial improvement over that of the previous months. The seasonally adjusted unemployment rate declined by 0.3 percent, and consumer and business spending are expanding. Buoyancy in business spending has added to existing productive capacity and has improved productivity, somewhat easing pressures on prices and costs. Fears that the brisk economic expansion and resultant labor shortages might fuel inflationary pressures have induced the Federal Reserve Board to raise short-term interest rates, causing a decline in new home purchases. The moderate rise in the Consumer Price Index (0.4 percent), however, shows that inflation is still under control, despite sporadic increases in some commodity prices and a one-percent rise in the Producer Price Index in February. Relatively low oil prices, improved business confidence and profit margins, moderate wage increases, buoyancy of capital spending, and the lagged effects of the dollar depreciation are still propelling the economic expansion.

Economic Growth

The annualized rate of real economic growth during the fourth quarter of 1988 was 2.7 percent in the United States, 3.3 percent in the United Kingdom, 3.4 percent in Canada, and 2.7 percent in West Germany. The latest available data indicate that the rate of real economic growth (annualized) during the third quarter of 1988 was 3.0 percent in France, 3.9 percent in Italy, and 5.6 percent in Japan.

Industrial Production

U.S. industrial production remained unchanged in February after rising 0.4 percent in January. Output increased in business equipment and home goods, but output of construction supplies, materials, and automobiles declined. Within the manufacturing sector, total production of all major industries remained unchanged after rising a revised 0.7 percent in January. U.S. industrial production in February 1989 was 5.0 percent higher than it was in February 1988.

Other major industrial countries reported the following annual growth rates of industrial production: Italy reported an increase of 6.0 percent (year ending November 1988), Canada and France reported increases of 2.7 and 4.3 percent, respectively (year ending December 1988); the United Kingdom reported an increase of 1.5 percent (year ending January 1989); West Germany reported an increase of 5.3 percent; and Japan reported an increase of 9.4 percent.

Average overall capacity utilization in U.S. factories, mines, and utilities in February 1989 was 84.3 percent, down by 0.2 percent from January. In manufacturing, capacity utilization in February stood at 84.6 percent compared with 84.4 percent in January 1989, and 82.4 percent in February 1988.

Prices

The seasonally adjusted U.S. Consumer Price Index increased 0.4 percent from January to February 1989. During the 1-year period ending in January 1989, consumer prices increased 4.3 percent in Canada, 7.5 percent in the United Kingdom, 3.3 percent in France, 4.7 percent in the United States,

1.1 percent in Japan, and 5.7 percent in Italy. During the 1-year period ending in February 1989, consumer prices increased 2.6 percent in West Germany.

Employment

The seasonally adjusted rate of unemployment in the United States (on a total labor force basis, including military personnel) declined to 5.1 percent in February from 5.4 percent in January 1989. West Germany reported an employment rate of 7.9 percent in February 1989. The national statistical offices of other countries reported the following unemployment rates in January: the United Kingdom, 7.0 percent; Japan, 2.3 percent: Italy, 16.4 percent; France 10.2 percent; and Canada, 7.6 percent. (For foreign unemployment rates adjusted to U.S. statistical concepts, see the tables at the end of this issue.)

The Budget Deficit

Table 1 shows Congressional Budget Office (CBO) projections of the budget deficit from 1988 to 1994. These projections are based on lower rates of economic growth and higher rates of interest and inflation than those used in projections by the Office of Management and Budget (OMB). Underlying the CBO's projections is the assumption that the economy has reached high levels of capacity utilization and that any further expansion would increase inflation and trigger monetary restraint to slow the economy to sustainable rates of growth.

Table 1
CBO baseline budget projections, 1/ by fiscal year, 1988-94

Item	(In billions of dollars) 1988	1989	1990	1991	1992	1993	1994
Deficit......................	155	155	141	140	135	129	122
Deficit target 2/............	144	136	100	64	28	0	-
Deficit as a percent of GNP..	3.2	3.0	2.6	2.4	2.2	2.0	1.7
Economic assumptions:							
GNP 3/....................	4,859	5,209	5,542	5,902	6,281	6,685	7,117
Real GNP growth rate......	3.8	2.9	2.1	2.2	2.2	2.3	2.3
Implicit GNP deflator.....	3.3	4.2	4.2	4.2	4.1	4.1	4.1

1/ The baseline budget projections include Social Security, which is off-budget.
2/ The Balanced Budget and Emergency Deficit Control and Reaffirmation Act of 1987 established these targets for 1988 through 1993.
3/ Calculated in billions of current dollars.

Source: Congressional Budget Office. The Economic and Budget Outlook: Fiscal Years 1990-1994. A Report to the Senate and House Committees on the Budget--Pt. 1.

U.S. Public Debt

Table 2 shows public debt as a percent of GDP/GNP for the Group of 7 (G-7), from 1980 to 1988, with projections to 1990. Over the 1980-88 period, U.S. public debt was lower than the average public debt of the G-7 as a group, and was also lower than the public debt of Japan, Italy, and Canada.

Table 2
Public Debt as a percent of GNP/GDP of G-7, 1980-90

Item	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
United States......	37.9	37.2	41.3	44.1	45.2	48.4	51.2	51.6	51.3	50.7	49.8
Japan.......	52.0	57.0	61.1	66.9	68.4	69.3	69.3	68.6	67.3	66.2	65.3
West Germany.....	32.5	36.3	39.5	40.9	41.5	42.2	42.4	43.3	44.1	44.3	45.0
France......	37.3	36.4	40.1	41.4	43.9	45.5	46.0	47.3	47.3	47.7	48.2
United Kingdom.....	54.6	54.7	53.4	53.6	54.9	53.6	52.9	50.4	46.1	42.1	38.6
Italy.......	58.5	60.5	66.3	71.9	77.0	83.6	87.9	91.3	94.2	97.2	100.4
Canada......	44.7	45.1	50.5	54.5	58.0	63.4	67.2	69.0	69.5	70.4	71.1
Total....	42.4	43.3	47.1	50.1	51.7	54.2	55.9	56.3	55.9	55.4	55.0

Source: OECD Economic Outlook, December 1988.

Forecasts

Table 3 shows newly revised macroeconomic projections for the U.S. economy in 1989, by four major forecasters, and the simple average of these forecasts. The forecasts represent percentage changes over the preceding quarterly period at annual rates. The average forecast is for a decline in nominal and real GNP growth rates starting the second quarter of 1989 and a slight increase in unemployment rates. The causes of the predicted economic downturn are a projected moderation in the pace of consumer spending, a decline in export growth, and a rise in short-term interest rates. Export growth rates are expected to slow, as the dollar appreciates in response to higher interest rates. Inflation (measured by the GNP deflator index) is expected to rise in the second and third quarters and moderate in the fourth quarter of 1989.

The OECD projects a 3.0 percent growth rate in U.S. real GNP for 1989, matching the average growth rate of OECD-Europe, and 2.5 percent growth in total demand, a half percentage point below the OECD-Europe average. The OECD projects that the U.S. inflation rate will reach 4.5 percent, a quarter percentage point lower than the OECD-Europe average inflation rate, and that U.S. unemployment rate will be at 5.5 percent compared with a 10.25-percent OECD-Europe average rate. The U.S. deficit on current account will reach $116 billion in 1989. World trade is projected to grow by 7.5 percent in 1989, compared with a growth rate of 9.0 percent in 1988.

In its latest forecasts, the International Monetary Fund (IMF) predicts that the overall output of industrial countries will increase by 2.8 percent in 1989 compared with a 3.9-percent increase in 1988, and inflation will rise slightly to 3.5 percent compared with 3.0 percent in 1988. Output of developing countries is expected to increase by 4.0 percent in 1989 compared

Table 3.
Projected quarterly percentage changes of selected U.S. economic indicators, 1989

Indicator and quarter	Data Resources Inc.	Merrill Lynch Economics Inc.	Wharton F.A. Inc.	UCLA Business Forecasting Project	Mean of 4 fore-casts
GNP: 1/					
January-March	8.1	9.5	9.1	8.8	8.9
April-June	5.2	6.7	6.6	5.1	5.9
July-September	4.9	4.2	6.2	4.2	4.9
October-December	5.0	3.7	6.8	4.7	5.0
GNP: 2/					
January-March	5.1	5.1	4.9	5.7	5.2
April-June	1.5	2.2	2.1	0.9	1.7
July-September	0.9	-0.3	1.7	-0.3	2.0
October-December	1.4	-0.6	1.7	0.4	0.7
GNP deflator index:					
January-March	2.8	4.2	4.7	2.9	3.6
April-June	3.7	4.4	4.6	4.2	4.2
July-September	4.0	4.5	4.4	4.5	4.3
October-December	3.5	4.3	3.8	4.3	4.0
Unemployment: 3/					
January-March	5.4	5.3	5.3	5.2	5.3
April-June	5.5	5.3	5.4	5.2	5.3
July-September	5.5	5.4	5.5	5.2	5.4
October-December	5.6	5.8	5.6	5.4	5.6

1/ Current dollars.
2/ 1982 dollars.
3/ Annual rate.
Note.--Percentage changes in the forecast represent compounded annual rates of change from preceding period. Quarterly data are seasonally adjusted.

Source: Compiled from data presented in The Conference Board, Statistical Bulletin, Vol.21, No.11, November 1988. Used with permission.

with 3.6 percent in 1988. World trade is projected to grow by 5.6 percent in 1989 compared with 7.6 percent in 1988.

U.S. Balance of Payments

Table 4 shows the U.S. balance of payments in 1983-88. The merchandise trade balance is the difference between merchandise imports and exports. The current account is the merchandise trade balance plus the balance on trade in services, which is composed largely of income on foreign investment. As a result of the large merchandise trade deficits and the rise in investment income payments to foreigners, the U.S. current account shows growing yearly deficits from 1983 to 1988. Concomitant with these deficits, foreign capital inflows increased markedly during this period, totaling $697 billion. U.S. net assets (direct and indirect investment) abroad grew by $348.0 billion during this period and net foreign assets in the United States grew by $936.2 billion. U.S. receipts from investment abroad totaled $548.3 billion and payments to foreigners totaled $437.0 billion.

Table 4
U.S. balance of payments, 1984-88.

Item	1983	1984	1985	1986	1987	1988 1/
	(In billions of dollars)					
Merchandise trade:						
Exports..................	201.8	219.9	215.9	224.0	249.6	316.3
Imports..................	-268.9	-332.4	-338.1	-368.5	-409.8	-441.5
Balance on merchandise trade 3/	-67.1	-112.5	-122.2	-144.5	-160.3	-125.2
Investment income:						
Receipts..................	77.3	85.9	88.8	90.1	103.8	102.4
Payments..................	-52.4	-67.4	-62.9	-67.0	-83.4	-103.9
Net.......................	24.9	18.5	25.9	23.1	20.4	-1.5
Net military transactions....	-.2	-2.1	-3.4	- 4.4	-2.4	-3.9
Net travel and transportation receipts.....	-4.2	-8.6	-10.0	-9.3	-10.3	-7.2
Other services, net..........	9.9	9.8	9.6	11.6	12.0	14.0
Balance on goods and services..	-36.8	-95.0	-100.1	-123.5	-140.5	-123.8
Unilateral transfers...........	-9.5	-12.1	-15.0	-15.3	-13.4	-12.0
Balance on current account.....	-46.2	-107.1	-115.1	-138.8	-154.0	-135.8
Capital account:						
U.S. assets abroad, net........	-49.8	-22.3	-32.6	-98.0	-76.0	-69.3
U.S. Official reserve assets 2/	-1.2	-3.1	-3.9	0.3	9.1	-7.8
Other U.S. Governments assets..	-5.0	-5.5	-2.8	-2.0	1.2	0.4
U.S. private assets............	-43.6	-13.7	-26.0	-96.3	-86.3	-62.0
Foreign assets in the United States, net.........	84.9	102.6	129.9	221.2	211.5	186.1
Foreign Official assets....	5.8	3.1	-1.2	35.5	45.0	36.9
Other foreign assets.......	79.0	99.5	131.1	185.7	166.5	149.2
Statistical discrepancy........	11.1	26.8	17.8	15.6	18.5	19.2
Balance on capital account	46.2	107.1	115.1	138.8	154.0	135.8

1/ First three quarters of 1988 are annualized.
2/ Consists of gold, special drawing rights, foreign currencies, and the U.S. reserve position in the International Monetary Fund (IMF).
3/ Because of rounding, figures might not add to totals.
Note 1.-- Capital outflows (-), Capital inflows (+).

Source: Economic report of the President, Jan. 1989.

U.S. TRADE DEVELOPMENTS

The seasonally adjusted U.S. merchandise trade deficit declined by 13.6 percent, from $11.0 billion in December 1988 to $9.5 billion in January 1989. The January deficit was 5.0 percent lower than the $10.0 billion average monthly deficit registered during the previous 12-month period, but was only 3.1 percent lower than the $9.8 billion deficit registered in January 1987. During the period from January 1988 to January 1989, the deficit was highest in February 1988 ($13.2 billion) and lowest in July 1988 ($8.8 billion).

Seasonally adjusted exports declined by $1.3 billion, from $29.1 billion in December 1988 to $27.8 billion in January 1989. Imports, however, declined more than exports, from $40.0 billion in December 1988 to $37.3 billion in January 1989.

In manufactured goods, total exports and imports decreased; however, imports declined more than exports. Consequently, the manufactures trade deficit declined by $1.8 billion, from $10.2 billion in December 1988 to $8.6 billion in January 1989. By commodity group, the biggest percentage gains in exports of manufactures were registered in chemical fertilizers, railway vehicles, nickel, power generating machinery, new cars, and undocumented exports to Canada. The biggest percentage decreases in imports were in automatic data processing equipment, office machinery, airplanes, airplane parts, pharmaceuticals, electrical machinery, glass, nonmonetary gold, metalworking machinery, musical instruments, photographic supplies, power generating machinery, scientific instruments and parts, specialized industrial machinery, telecommunications apparatus equipment and parts, textile yarns and fabrics, and new cars from Japan. The oil import bill

increased from $3.3 billion to $3.6 billion. The agricultural trade surplus declined from $1.9 billion in December 1988 to $1.4 billion in January 1989.

On a regional basis, the United States experienced improvements in its deficits with Western Europe, Japan, and the Newly Industrialized Economies (NIEs), and a worsening in its trade deficit with Canada and communist areas in Europe and Asia. The trade balance with Western Europe turned from a deficit of $1.2 billion in December 1988 into a surplus of $46 million. The deficit with Japan declined from $5.1 billion in December 1988 to $3.5 billion in January 1989. The deficit with West Germany declined from $1.3 billion to $716 million. The deficit with the NIEs declined slightly to $2.4 billion from $2.5 billion. The deficit with Canada worsened by almost one-half, from $985 million in December to $1.7 billion in January, and the deficit with developing countries as a whole increased from $3.2 billion to $4.3 billion. The deficit with OPEC nations increased from $620 million in December 1988 to $1.1 billion in January 1989.

Expansion of CBI Program Appears Likely

The Caribbean Economic Recovery Act (CBERA), commonly referred to as the Caribbean Basin Initiative (CBI), went into effect on January 1, 1984, with the objective of stimulating growth and promoting structural reform of the economies of the Caribbean Basin. Currently 22 Caribbean countries are designated as beneficiaries of the program. One objective of the CBI program was to enhance the Caribbean Basin's export earnings and encourage export diversification by granting beneficiary countries duty-free trade access to the U.S. market on selected products. Debate has persisted, however, over the program's scope and impact on the beneficiary economies. One central issue has been the legislatively mandated restrictions that exclude certain products from the program.

Some critics have pointed to the nearly 31-percent decline in U.S. imports from the Caribbean Basin since the inception of the CBI as an indication of the program's failure (see table 1). However, exports from the region to the United States have actually increased in value, apart from petroleum imports for which the world price has declined substantially. More importantly, over the last four years the value of imports entering duty free under the CBI program have increased nearly 40 percent, outpacing the 35- growth in total U.S. imports. After climbing steadily since 1985, however, CBI imports dropped slightly in 1988 to about $801 million. Last year, imports entering under the CBI accounted for 13 percent of all U.S. imports from the Caribbean, the same share as those in 1987, and less than 2 percent of total U.S. imports.

Table 1
U.S. imports for consumption from countries in the Caribbean Basin, 1984-88[1]

(In thousands of dollars, customs value)

Imports	1984	1985	1986	1987	1988
Total.............	8,896,499	6,849,928	6,186,826	6,178,052	6,172,278
CBI duty-free.....	576,906	497,309	680,463	802,567	800,791
CBI as percent of total........	6.5	7.3	11.0	13.0	13.0

[1] Figures are for designated and nondesignated countries under the CBERA and are net of certain MFN duty-free items that were erroneously included in the trade statistics.

Source: Compiled from official statistics of the U.S. Department of Commerce.

To address concerns that the current CBI has not achieved the results intended, on March 2 Chairman Sam Gibbons of the House Ways and Means Trade Subcommittee and Senator Bob Graham introduced the Caribbean Basin Economic Recovery Expansion Act (H.R.1233 and S.504), commonly referred to as CBI-II. Such legislation was previously introduced in August 1987 (H.R.3101 and S.1544), but did not come to a vote. The CBI-II bills now being considered would repeal the September 30, 1995 expiration date of CBI, extending the program indefinitely, and would grant limited duty-free preferences to items that are currently exempt from the program.

Products that are ineligible for duty-free treatment under the existing CBI include: certain items of footwear, handbags, luggage, flatgoods, work gloves, and leather wearing apparel that are not eligible for duty-free entry under the Generalized System of Preferences; canned tuna; petroleum and petroleum products; and watches and watch parts of which any component originated in a Communist country. As proposed, the legislation would group these products into "special categories," each of which would receive duty-free treatment up to a level equaling 5 percent of the total quantity of U.S.

imports in that category. If in any year CBI imports should exceed the 5-percent limit, the following year each beneficiary would be subject to a "national duty-free quota" for that category. For each country and product category, the "national duty-free quota" would be calculated as the quantity of imports the prior year plus 3 percent. In 1988, the United States imported almost $1.1 billion worth of these articles from CBI beneficiaries (see table 2). Duties collected on these imports were estimated at almost $14 million. Inclusion of these products would have more than doubled the value of CBI imports last year.

Table 2
U.S. imports from CBI beneficiaries of selected items currently exempt from program benefits, customs value, and calculated duties collected, 1988 [1]

(In thousands of dollars)

Item	Customs value	Calculated Duties collected
Total	1,099,937	13,918
Petroleum and petroleum products..........	1,053,476	8,227
Handbags, luggage, and flatgoods...............	20,244	2,760
Footwear......................	15,357	1,685
Work Gloves	7,429	1,039
Leather apparel...............	3,386	203
Watches and parts.............	31	3
Canned Tuna...................	14	1

[1] Figures are preliminary and are for countries designated as beneficiaries as of Jan. 1, 1989.

Source: Compiled from official statistics of the U.S. Department of Commerce.

The CBI-II bills also propose expanding duty-free treatment for textile and apparel imports. As written in the legislation, duty-free access would be granted on the total value of textile and apparel imports that are made from "qualifying fabrics" and those that enter under Guaranteed Access Level (GAL) quotas which are negotiated with each beneficiary. "Qualifying" fabrics are

those formed and cut in the United States and certain foreign fabrics that are of a type not produced in the United States or that are in "critical supply." Most textile and apparel imports are excluded from the existing CBI program. However, countries designated under the CBI are the sole beneficiaries of the 807-A program, which allows duty-free treatment for textile and apparel imports entering under GALs, but only on the "qualifying fabric" component. (Under the new Harmonized System tariff nomenclature that took effect January 1, 1989, item TSUS 807-A HTS 9802.00.80.10.) Textile and apparel imports entering under item 807-A grew from about $1.0 million in 1986, the first year of the program, to $219.3 million last year. The dutiable value of 807-A imports totaled $57.6 million in 1988.

Another provision of the new CBI-II legislation allocates a minimum sugar quota to program beneficiaries. The bills set a floor for overall CBI sugar imports at the actual 1989 aggregated CBI quota of 371,449 metric tons. The 1989 global sugar quota is 1,123,440 metric tons. If the global sugar quota shrinks again, as was the trend until the 1988 drought induced an increase, the shares of other supplying countries will inevitably be squeezed.

The CBI-II bills also provide for a separate injury determination for CBI beneficiaries in countervailing duty and antidumping cases; an increase in the duty-free allowance for U.S. residents returning from a CBI beneficiary country (from $400 to $600); and the establishment of a pilot customs program to test the effect of preclearance operations on tourism in the region.

Chairman Sam Gibbons is optimistic that legislation modifying the CBI program will pass this year. In introducing H.R. 1233, he noted that several of the more controversial provisions of the earlier CBI-II legislation had been removed or modified to address concerns raised during the course of

consultations and hearings. With bipartisan backing and Bush administration support for strengthening the CBI program, legislative action appears likely during this session of Congress. Bill S.504 has been referred to the Senate Finance Committee and bill H.R.1233, which is currently in subcommittee, is expected to reach the full committee for consideration by mid-April.

Japan-United States FSX Project Approved With Modifications

A joint United States-Japan plan to develop a next-generation fighter support plane, the FSX (an adaptation of the F-16), was approved by President Bush pending certain modifications to the original agreement. The original agreement was reached between the U.S. Department of Defense and the Japan Defense Agency but ran into opposition from the Congress and trade Agencies. Now, the Japanese Government must approve the modifications before the agreement goes forward to Congress. Negotiations with Japanese officials have left several major issues unresolved, but reportedly the agreement is expected to go forward.

The joint plan has been the subject of criticism and opposition from Congress, some Government agencies, and private parties, and has been the subject of a White House-mandated interagency review. According to press reports, the agreement divided President Bush's Cabinet: the National Security Council and the State and Defense Departments supported the agreement, but the Commerce Department and other economic and trade agencies opposed it. At a Cabinet meeting on March 16, the various agencies presented three possible options to the President: go forward with the project as negotiated; modify the terms of the agreement by imposing stricter safeguards on technology transfer to Japan; or scrap the agreement entirely and induce the Japanese to buy F-16's. The President confirmed on March 21 that he had decided to approve the agreement, but with certain clarifications to better protect the computer "source code" that helps fly and control the plane and processes other sensitive data. The administration will also require that some of the jets be built in the United States.

The FSX will be based upon General Dynamic's F-16 technology and will replace Japan's aging F-1s and F-4s. The plans are to build approximately 130 planes at an estimated cost of $42.2 million each, with followup orders expected. Mass production of the planes is scheduled for 1997. The total cost of the project is estimated at $8.2 billion. Japan will pay for the cost of development, which is expected to cost an estimated $1.3 billion (at Y125=$1.00). U.S. firms' share of the research and development work will be between 35 and 45 percent. The Defense Department and the U.S. companies will also share the costs of design and prototype testing.

Several issues remain unresolved: what proportion of the FSX should be produced by U.S. firms (the administration is reportedly pressing for 40 percent), how much of the technology arising from the design will flow back to the United States, and who will have the patent rights to that technology. Following approval of the changes by the Japanese Government, the Administration will submit the agreement to Congress. Unless Congress passes a joint resolution specifically prohibiting the agreement, an export license permitting the export of the technology will be issued and the plan will go into effect.

Negotiations between the United States and Japan began during the fall of 1987 then progressed slowly. A memorandum of understanding (MOU) on development of the fighter was negotiated with the Japanese by the State and Defense Departments, and signed on November 29, 1988. At first the two Governments disagreed over how the research, development, and production phases would be split between companies in Japan and the United States. Another area of disagreement was the transfer of technology back to the United States. Of particular concern were Japanese technical refinements to existing

F-16 technology and the availability of new technology developed by the Japanese. The agreement now says that Japanese refinements to U.S.-developed technology already incorporated in the F-16 will be shared with the United States at no cost. New technology developed by the Japanese would have to be purchased by U.S. firms.

When the agreement was finally signed by Defense Department and Japan Defense Agency officials, it left a number of details to be worked out by the firms involved. Mitsubishi Heavy Industries, the primary Japanese contractor, and General Dynamics, the primary American contractor, disagreed on several issues in the months following the signing. In particular, the question of which firms would develop and produce the wing technology was difficult to resolve. Both companies wanted the wing prototypes to be developed and built in their own country. The two companies finally agreed that Japan will take the primary role in remodeling and developing the main wing. Main wings for two of the six FSX planes produced on an experimental basis, however, will be manufactured by General Dynamics in the United States using the same designs and raw material as Mitsubishi Heavy Industries. The wings will then be shipped to Japan for assembly and testing.

In early February the bilateral agreement ran into another snag when members of Congress wrote to the President and expressed their concern that the long-term impact on the health and competitiveness of the American aerospace industry had not adequately been taken into consideration during the negotiations. They urged that a review of the agreement be conducted by all pertinent Cabinet departments. Once the review began, interagency differences over the sharing of technology and concerns that the agreement amounted to a giveaway of U.S. technology delayed consensus on the agreement. During

February and March, Congressional opposition continued to mount, several hearings were held, additional letters of concern were sent to the President, and the General Accounting Office was asked to study the competitive effect of the agreement upon the U.S. aircraft industry.

The current controversy over joint development of the FSX is ironic. Originally, the Japanese intended to develop and build a fighter by themselves, with no participation by the United States. It was only after suggestions by U.S. officials that Japan purchase F-16s "off the shelf" (to reduce Japan's trade imbalance) were rejected, that the Japanese were convinced that a joint project would be mutually beneficial for both trade and defense reasons. The U.S. defense industry believed that it would benefit from the agreement because of the development of new technology that could be used to improve the F-16 or other defense equipment. The State Department believed that the joint project would prove beneficial for both foreign policy and defense reasons, and at the same time, contribute to reducing the trade deficit the United States has with Japan.

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